increases are reductions in expenses due to renegotiation of interconnection agreements with ILECs. Operating expenses increased to $283.4 million for 1997 from $172.4 million on a pro forma basis for 1996, an increase of $111.0 million, or 64%. Operating expenses were approximately 57% and 59% of revenue for the years ended December 31, 1997 and 1996, respectively, and 61% of revenue for the year ended December 31, 1996 on a pro forma basis.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased to $166.0 million for 1997 from $85.0 million for 1996, an increase of $81.0 million, or 95%. Pursuant to the TCG Reorganization, TCG consolidated the financial statements of the Local Market Partnerships, the selling, general and administrative expenses of which accounted for 23% of the total selling, general and administrative expenses for the year ended December 31, 1997. The remaining increase is a result of the continued expansion of network infrastructure to support continued expansion of the Company's networks, including costs associated with servicing the increased number of dedicated, switched, data and Internet services customers. These costs include expenses related to compensation, including commissions, occupancy, professional fees and various marketing and promotional expenses. Selling, general and administrative expenses increased to $166.0 million for 1997 from $98.4 million, on a pro forma basis, for 1996, an increase of $67.6 million, or 69%. Selling, general and administrative expenses were approximately 34% and 32% of revenue for the years ended December 31, 1997 and 1996, respectively, and 35% of revenue for the year ended December 31, 1996 on a pro forma basis.

EBITDA

TCG recorded a one-time, non-recurring charge of $22 million for certain acquired in-process research and development costs related to the acquisition of CERFnet. For comparison purposes, Recurring EBITDA for 1997 is defined as EBITDA excluding the one-time charge for acquired in-process research and development costs. Recurring EBITDA increased to $44.9 million for 1997 from EBITDA of $25.1 million for 1996, an increase of $19.8 million. The increase in Recurring EBITDA is primarily attributable to increases in dedicated and switched revenues. Recurring EBITDA increased to $44.9 million for 1997 from EBITDA of $12.6 million on a pro forma basis for 1996, an increase of $32.3 million. Comparing 1997 to 1996 on a pro forma basis, TCG has reduced its operating and administrative expenses, as a percentage of revenues, primarily by obtaining lower unit access costs through negotiation of, and participation in, regulatory proceedings relating to various interconnection and reciprocal agreements with ILECs across the country, and by obtaining greater efficiencies through automation.

Depreciation and Amortization Expense

Depreciation and amortization expense increased to $155.4 million for 1997 from $78.4 million for 1996, an increase of $77.0 million, or 98%. This increase is primarily attributable to increased depreciation associated with the expansion of the local telecommunications networks throughout the country and increased amortization of goodwill, FCC licenses and other intangibles related to various 1997 and 1996 acquisitions. Depreciation and amortization expense increased to $155.4 million for 1997 from $96.3 million on a pro forma basis for 1996, an increase of $59.1 million, or 61%.

Interest Income

Interest income increased to $31.1 million for 1997 from $30.2 million for 1996, an increase of $0.9 million. This increase is attributable to an increase in the average outstanding balance of cash and cash equivalents and marketable securities that resulted from the proceeds of the 1996 Offerings and the 1997 Equity Offering.

Year Ended December 31, 1997 Compared to Year Ended December 31, 1996

Revenues

Total revenues increased to $494.3 million for 1997 from $267.7 million for 1996, representing an increase of $226.6 million, or 85%. Pursuant to the TCG Reorganization, TCG consolidated the financial statements of the Local Market Partnerships, which accounted for 17% of total revenue for the year ended December 31, 1997. Telecommunications services revenue increased to $494.3 million for 1997 from $244.9 million for 1996, an increase of $249.4 million, or 102%. Revenues increased in every category, most significantly in switched services. These increases reflect increased sales of services in existing and new markets and the growth of TCG's customer base. Had telecommunications services revenue generated by unconsolidated Local Market Partnerships been included in the consolidated financial statements of the Company for all of 1996, total revenues would have increased to $494.3 million for 1997 from $283.4 million for 1996, on a pro forma basis, an increase of $210.9 million, or 74%. This growth in revenues is a direct result of increased market penetration of all telecommunications services offered in existing markets and the addition of new markets. Total revenues for the year ended December 31, 1997, include $48.1 million attributable to (i) ETC and CERFnet, which were acquired by TCG during the first quarter of 1997, and (ii) BizTel, which was acquired by TCG in the last quarter of 1997. TCG consolidated the financial statements of ETC, CERFnet and BizTel from the dates of acquisition.

Annualized monthly recurring revenue increased to approximately $619.9 million for December 1997 from $329.0 million on a pro forma basis for December 1996, an increase of $290.9 million, or 88%. Monthly recurring revenue represents monthly service charges billable to telecommunications services customers for the month indicated, excluding non-recurring revenues for certain one-time services, such as installation fees or equipment charges.

Switched services revenue increased to $215.2 million for 1997 from $113.0 million on a pro forma basis for 1996, an increase of $102.2 million, or 90%. The increase is due primarily to: increases in switched, local and toll services revenue; long distance carrier access usage volumes; and sales of additional enhanced switched services products to customers in existing and new markets. Dedicated services revenue increased to $252.4 million for 1997 from $161.7 million for 1996, on a pro forma basis, an increase of $90.7 million, or 56%. TCG's data and Internet revenues increased to $22.1 million for 1997 from $1.5 million on a pro forma basis for 1996, an increase of $20.6 million.

Management fees were directly related to operating and administrative support services provided by TCG to the Local Market Partnerships. Royalty fees were charged to the Local Market Partnerships based on revenue. As a result of the TCG Reorganization, management and royalty fees from the Local Market Partnerships were no longer reflected as revenue beginning July 1, 1996, due to the consolidation of the Local Market Partnerships.

Operating Expenses

Operating expenses increased to $283.4 million for 1997 from $157.6 million for 1996, an increase of $125.8 million, or 80%. Pursuant to the TCG Reorganization, TCG consolidated the financial statements of the Local Market Partnerships, the operating expenses of which accounted for 17% of the total operating expenses for the year ended December 31, 1997. The remaining increases are primarily attributable to costs associated with the expansion of networks throughout the country, including compensation costs for technical personnel, access, bad debt, rent and maintenance expenses. The increase in operating expenses is also attributable to the access and maintenance expenses associated with the growth of switched services in existing markets and the expansion into new markets. Offsetting these expense

Results of Operations

The following table presents historical financial information for 1997 and 1996 and unaudited pro forma financial data for 1996, as if the TCG Reorganization had occurred at the beginning of the year. Pro forma adjustments include the reversal of TCG's equity in losses of 13 Local Market Partnerships for 1996, as well as amortization of the goodwill which was recorded upon closing of the transactions and the reduction of interest expense from the conversion to equity of subordinated debt owed by TCG to the Cable Stockholders. Such information is presented for a more meaningful comparison between 1997 and 1996. The unaudited pro forma financial data does not purport to represent what TCG's results of operations or financial condition would actually have been if the transactions that give the rise to the pro forma adjustments had occurred on the date assumed.

(Dollars in Thousands, Except Share Amounts)	Years Ended December 31, 1997	Years Ended December 31, 1996	Pro Forma for the TCG Reorganization Year Ended December 31, 1996
Statements of Operations Data:			
Revenues:			
Telecommunications service	**$ 494,304**	$244,864	$ 283,383
Management and royalty fees from Local Market Partnerships	**—**	22,805	—
Total Revenues	**494,304**	267,669	283,383
Operating expenses	**283,440**	157,591	172,374
Selling, general and administrative expenses	**165,977**	85,025	98,436
In-process research and development costs	**22,000**	—	—
Depreciation and amortization	**155,402**	78,416	96,260
Operating loss	**(132,515)**	(53,363)	(83,687)
Interest:			
Interest income	**31,111**	30,219	29,163
Interest expense	**(116,172)**	(73,633)	(66,946)
Net interest expense	**(85,061)**	(43,414)	(37,783)
Minority interest	**—**	3,520	4,713
Equity in losses of unconsolidated affiliates	**(3,427)**	(19,400)	(7,650)
Loss before income taxes	**(221,003)**	(112,657)	(124,407)
Income tax provision	**(1,664)**	(2,193)	(2,193)
Net loss	**$(222,667)**	$(114,850)	$(126,600)
Net loss per share	**$ (1.34)**	$ (1.00)	$ (0.86)
Weighted average number of shares	**165,728,059**	114,443,695	146,423,705

Under the terms of various management services arrangements among TCG and its unconsolidated Local Market Partnerships and certain other affiliates, TCG provided operating and administrative support services to such entities, for which it earned management fees. Upon consummation of the TCG Reorganization, these fees were no longer reflected as revenues.

Included in selling, general, and administrative expenses are expenses incurred for services provided to the Local Market Partnerships, in the amount of $21.4 million, for the year 1996

In December 1997, TCG evaluated the acquired assets and liabilities of CERFnet, and as a result of the evaluation, TCG expensed acquired in-process research and development costs

Minority interest reflects TCI and Continental affiliates' interests in TCG St. Louis for 1996. In 1996, after giving effect to the TCG Reorganization and the 1996 Offering, the minority interest reflects Viacom Telecom, Inc.'s equity interests of 22.2% and 22.9% in TCG Seattle and TCG San Francisco, respectively, and InterMedia Partners' equity interest of 4.2% in TCG San Francisco.
In 1997 TCG no longer recorded minority interest for the Local Market Partnerships due to the completion of the TCG Reorganization.

Pro forma financial information for the year ended December 31, 1996 is as if the TCG Reorganization had occurred at the beginning of the year. Pro forma adjustments include the reversal of TCG's equity in the losses of 13 Local Market Partnerships, as well as amortization of the goodwill which was recorded upon closing of the transactions and the reduction of interest expense from the conversion to equity of subordinated debt owned by TCG to the Cable Stockholders. Such information is presented for a more meaningful comparison between 1997 and 1996.

consolidated subsidiaries, "TCI"), Cox Communications, Inc. (together with its consolidated subsidiaries, "Cox"), Comcast Corporation (together with its consolidated subsidiaries, "Comcast") and, for periods prior to November 13, 1997, MediaOne of Delaware, Inc., formerly Continental Cablevision, Inc. (together with its consolidated subsidiaries, "Continental") (collectively, the "Cable Stockholders"). In June 1996, TCG and the Cable Stockholders completed the consolidation of the ownership of TCG Partners (a New York general partnership which was initially owned by the Cable Stockholders in the same percentages as TCG) and of 14 local market partnerships (the "Local Market Partnerships") as wholly-owned subsidiaries of TCG (the "TCG Reorganization").

The business was operated through TCG and, beginning in 1992, TCG Partners, which is a New York general partnership owned prior to the TCG Reorganization by the Cable Stockholders in the same percentages as TCG. TCG Partners was formed to invest, with TCG, the Cable Stockholders and other cable operators, in 14 Local Market Partnerships to develop and operate local telecommunications networks. The Local Market Partnerships were owned by TCG, and/or TCG Partners, certain of the Cable Stockholders which had cable operations in the particular markets addressed by the Local Market Partnerships and, in some cases, other cable operators in such markets. To simplify this complex ownership structure, the Company and the Cable Stockholders completed the TCG Reorganization whereby, TCG agreed to consolidate the ownership of TCG Partners and of the Local Market Partnerships as wholly-owned subsidiaries of TCG. As part of this process, certain of the other cable operators agreed to sell their interests in the Local Market Partnerships to TCG directly or through a Cable Stockholder. The financial statements for one of the Local Market Partnerships were previously consolidated with those of TCG. Therefore, as a result of the TCG Reorganization, TCG consolidated the financial statements of the remaining 13 of the 14 Local Market Partnerships.

In response to customer demand, the Company plans to increase the geographic reach and density of its existing networks by deploying additional fiber optic rings and connecting additional customers to its networks. The costs associated with the initial installation and expansion of each network, including development, installation, certain organizational costs and early operating expenses, are significant and result in negative cash flow for that market until an adequate customer base and revenue stream have been established. In addition to capital expenditures, TCG begins to incur direct operating costs upon commencement of the installation phase of a network for such items as salaries and office rent. The exact amounts and timing of these expenditures and costs are subject to a variety of factors which may vary greatly by geographic market. As network installation progresses, TCG incurs rights-of-way costs, increased sales and marketing expenses (including sales commissions) and, in certain markets, franchise fees and taxes paid to local governments based on revenue. Although TCG's revenues have increased substantially, TCG's expenses associated with the expansion and development of its local telecommunications networks have exceeded such revenues. TCG expects its net losses to grow as it continues to expand its networks. However, generally, after the network infrastructure is established, TCG can add customers and increase revenues with less additional expense. After a customer is added and the volume of such customer's communications traffic handled by TCG grows, incremental revenues can be added with minimal additional expense, providing significant contributions to EBITDA (earnings (loss) before interest, income taxes, depreciation, amortization, minority interest and equity in losses of unconsolidated affiliates). For 1997, "Recurring EBITDA" is defined as EBITDA excluding a one-time non-recurring charge for acquired in-process research and development costs. See "Year Ended December 31, 1997 Compared to Year Ended December 31, 1996 — EBITDA."

As of December 31, 1997, TCG's consolidated financial statements reflect the results of TCG's wholly-owned subsidiaries. The consolidated statements of operations and cash flows include equity in the losses of BizTel for ten months and of ETC for two months. Effective as of June 1, 1997, TCG entered into a Technical Services Agreement with KCFN whereby TCG agreed to provide certain management services to KCFN. TCG has recorded the results of operations from that date.

For the year ended December 31, 1997, TCG's capital expenditures, its acquisitions and working capital were funded by the 1997 Equity Offering, which raised approximately $328.7 million of aggregate gross proceeds and the 1996 Offerings, which raised approximately $1.3 billion of aggregate gross proceeds.

The development of TCG's business, the construction and expansion of its telecommunications networks and its operating expenses require significant expenditures, often resulting in negative cash flow. Although TCG generated positive Recurring EBITDA for 1997, several of its subsidiaries did not and will not generate positive EBITDA until such time as adequate customer bases are established.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Teleport Communications Group Inc. ("TCG" or the "Company"), the first and largest competitive local exchange carrier ("CLEC") in the United States, offers comprehensive telecommunications services in major metropolitan markets nationwide. The Company competes with incumbent local exchange carriers ("ILECs") by providing high quality, integrated telecommunications services, primarily over fiber optic digital networks, to meet the voice, data and video transmission needs of its customers. TCG's customers are principally telecommunications-intensive businesses, healthcare and educational institutions, governmental agencies, long distance carriers and resellers, Internet service providers, disaster recovery service providers, wireless communications companies and financial services companies. TCG offers these customers technologically advanced telecommunications services, as well as superior customer service, flexible pricing and vendor and route diversity. During 1997 TCG completed the acquisitions of Eastern TeleLogic Corporation ("ETC"), now known as TCG Delaware Valley, Inc., CERFnet Services, Inc. ("CERFnet"), now known as TCG CERFnet, Inc., and BizTel Communications, Inc. ("BizTel"). TCG expects to complete the acquisitions of ACC Corporation and of Kansas City Fiber Network, L.P. ("KCFN") by May 1, 1998 and by August 1, 1998, respectively.

On November 26, 1997, TCG entered into an Agreement and Plan of Merger (the "ACC Agreement") by and among TCG, TCG Merger Co., Inc., a Delaware corporation and a wholly-owned subsidiary of TCG ("MergerCo") and ACC Corp., a Delaware corporation ("ACC"), providing for the merger of MergerCo with and into ACC (the "ACC Merger"), with ACC becoming a wholly-owned subsidiary of TCG. A copy of the ACC Agreement has been filed with the Security Exchange Commission as an exhibit to TCG's Registration Statement on Form S-4 (File No. 333-45833) (the "ACC S-4").

On January 8, 1998, TCG entered into an Agreement and Plan of Merger (the "AT&T Agreement") with AT&T Corp., a New York Corporation ("AT&T"), and TA Merger Corp., a Delaware corporation and a wholly-owned subsidiary of AT&T ("AT&T Merger Sub"), pursuant to which subject to satisfaction of the closing conditions specified therein, AT&T Merger Sub would merge with and into TCG, with TCG surviving as a wholly-owned subsidiary of AT&T ("the AT&T Merger"). In the AT&T Merger, each share of TCG Class A Common Stock (including shares issued to former ACC Stockholders in the ACC Merger, assuming that the ACC Merger occurs prior to the AT&T Merger) and each share of the Class B Common Stock of TCG, par value $0.01 per share (the "TCG Class B Common Stock," and together with the TCG Class A Common Stock, the "TCG Common Stock"), will be converted into 0.943 of a share of AT&T common stock. TCG and AT&T expect that the exchange will be tax-free to TCG Shareholders, except to the extent cash is received in lieu of fractional shares. The AT&T Agreement contains customary representations and warranties of the parties, which will not survive effectiveness of the AT&T Merger. In addition, the AT&T Agreement contains certain restrictions on the conduct of TCG's business prior to the consummation of the AT&T Merger. Pursuant to the AT&T Agreement, TCG has agreed, for the period prior to the AT&T Merger, to operate its business in the ordinary course, refrain from taking various corporate actions without the consent of AT&T, and not solicit or enter into negotiations or agreements relating to a competing business combination.

For over 13 years, TCG has developed, operated and expanded its local telecommunications networks. During the fourth quarter of 1997, TCG added eight new markets, which brings total Metropolitan Statistical Areas ("MSAs") served by TCG to 65. These 65 MSAs are in metropolitan New York/New Jersey, Los Angeles, Chicago, San Francisco, Philadelphia, Boston, Detroit, Baltimore, Washington, D.C., Dallas, Houston, Miami/Ft. Lauderdale, Seattle, San Diego, St. Louis, Pittsburgh, Phoenix, Denver, Milwaukee, Indianapolis, Hartford, Omaha, Providence, Cleveland, Portland (Oregon), Salt Lake City, Nashville, Chattanooga, Knoxville, Birmingham, Cincinnati, Columbus (Ohio), Charlotte, Tampa Bay, Sacramento, Minneapolis-St. Paul, Atlanta and Orlando, including 19 of the 20 largest metropolitan areas. As of December 31, 1997, the Company's fiber optic networks spanned over 9,470 route miles, contained over 491,090 fiber miles and served approximately 13,510 buildings.

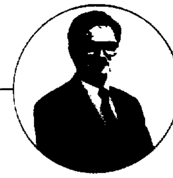
On July 2, 1996, TCG issued 27,025,000 shares of TCG Class A Common Stock (the "Stock Offering") which resulted in gross proceeds of approximately $432.4 million as part of an initial public offering, $300 million of 9⅞% Senior Notes due 2006 (the "1996 Senior Notes") and $1,073 million aggregate principal amount at maturity of 11⅛% Senior Discount Notes due 2007 (the "1996 Senior Discount Notes" and, together with the 1996 Senior Notes, the "1996 Notes"). Prior to the 1996 Notes offering and the Stock Offering (collectively, the "1996 Offerings"), TCG was owned by subsidiaries of its Class B stockholders, TCI Communications, Inc. (together with its

TCG CORPORATE OFFICERS

W. Terrell Wingfield, Jr.
Vice President and
General Counsel

Robert Annunziata
Chairman, President
and Chief Executive
Officer

Robert C. Atkinson
Senior Vice President
Legal, Regulatory and
External Affairs



Kenneth A. Shulman
Senior Vice President
Technology

Marsha Gewirtzman
Senior Vice President
People Services

John A. Scarpati
Senior Vice President and
Chief Financial Officer

Joel D. Gross
Senior Vice President
Corporate Development

TCG

Executive Committee

Stuart A. Mencher
Senior Vice President
Sales and Marketing

Al Hansen
Senior Vice President
Emerging Markets

Marvin L. Lindsey
Senior Vice President
Management
Information Systems

J. Curt Hockemeier
Senior Vice President
Network Operations

Wayne G. Fox
Vice President and
Treasurer

Maria Terranova-Evans
Vice President and
Controller

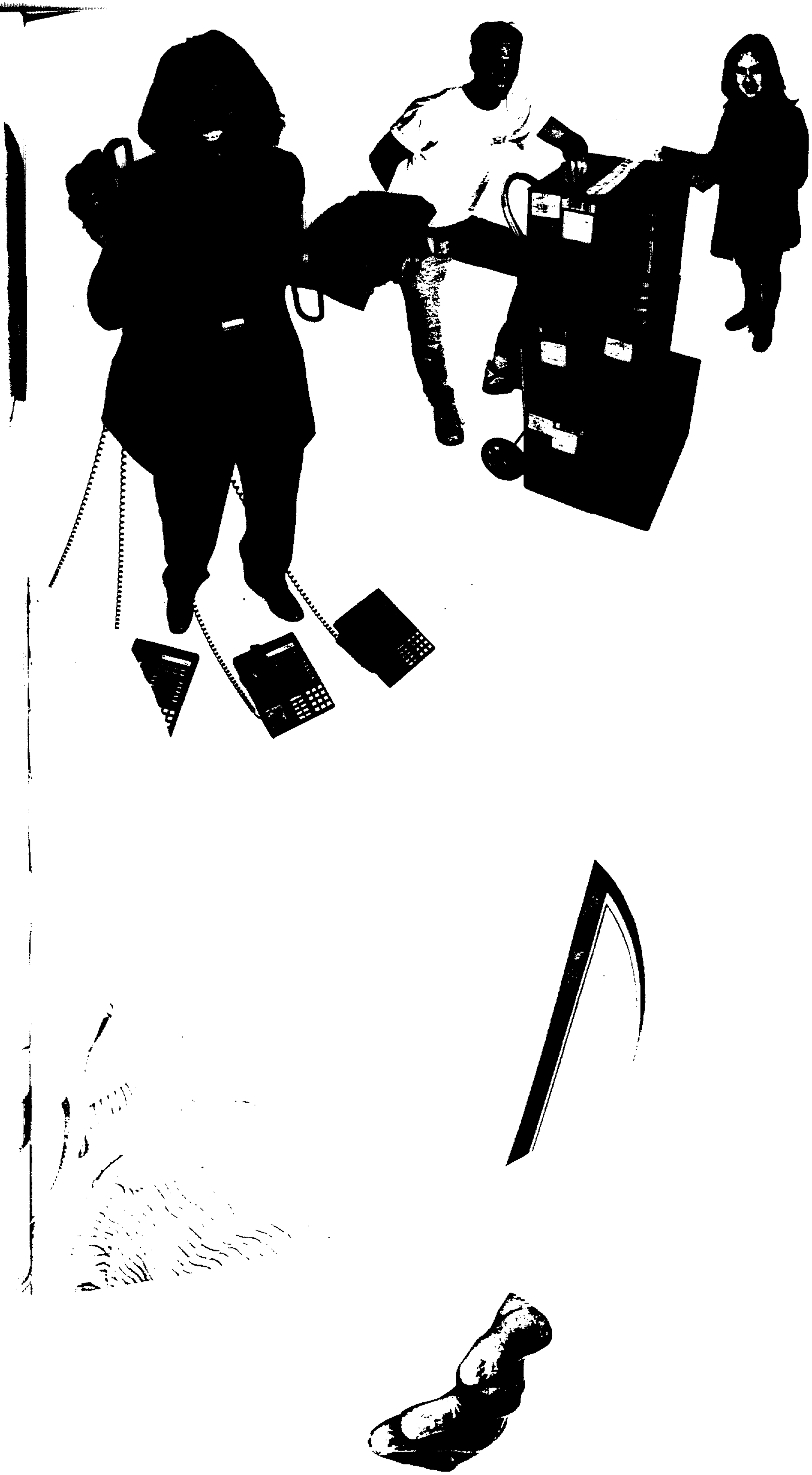
John Thomson
Vice President and
Corporate Secretary

Speed

TCG operates in 65 major markets: 9,500 miles of fiber optic cable... 227 miles more each month; 3,510 buildings...149 buildings added each month; 3,059 managers and associates... more than 100 added each month; 2,211 Synchronous Optical Network (SONET) Systems... adding nearly 60 a month; 35 multi-million dollar digital voice switches... one installed almost every month. Expanding the realm of advanced competitive telecommunications. Daily.

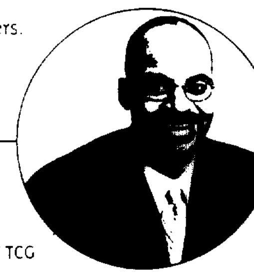
"FIBER OPTIC SPEED IS TERRIFIC. BUT MORE IMPORTANT THAN FIBER OPTIC SPEED IS THE RESPONSE TIME OF THE COMPANY THAT PROVIDES IT. NO ONE HAS MOVED MORE SWIFTLY WITH MORE SERVICES THAN TCG TO SERVE THE UNIVERSITY'S STUDENTS, ADMINISTRATION, FACULTY AND STAFF."

Sister Canise Kolbeck,
Telecommunications Director,
Cardinal Stritch University



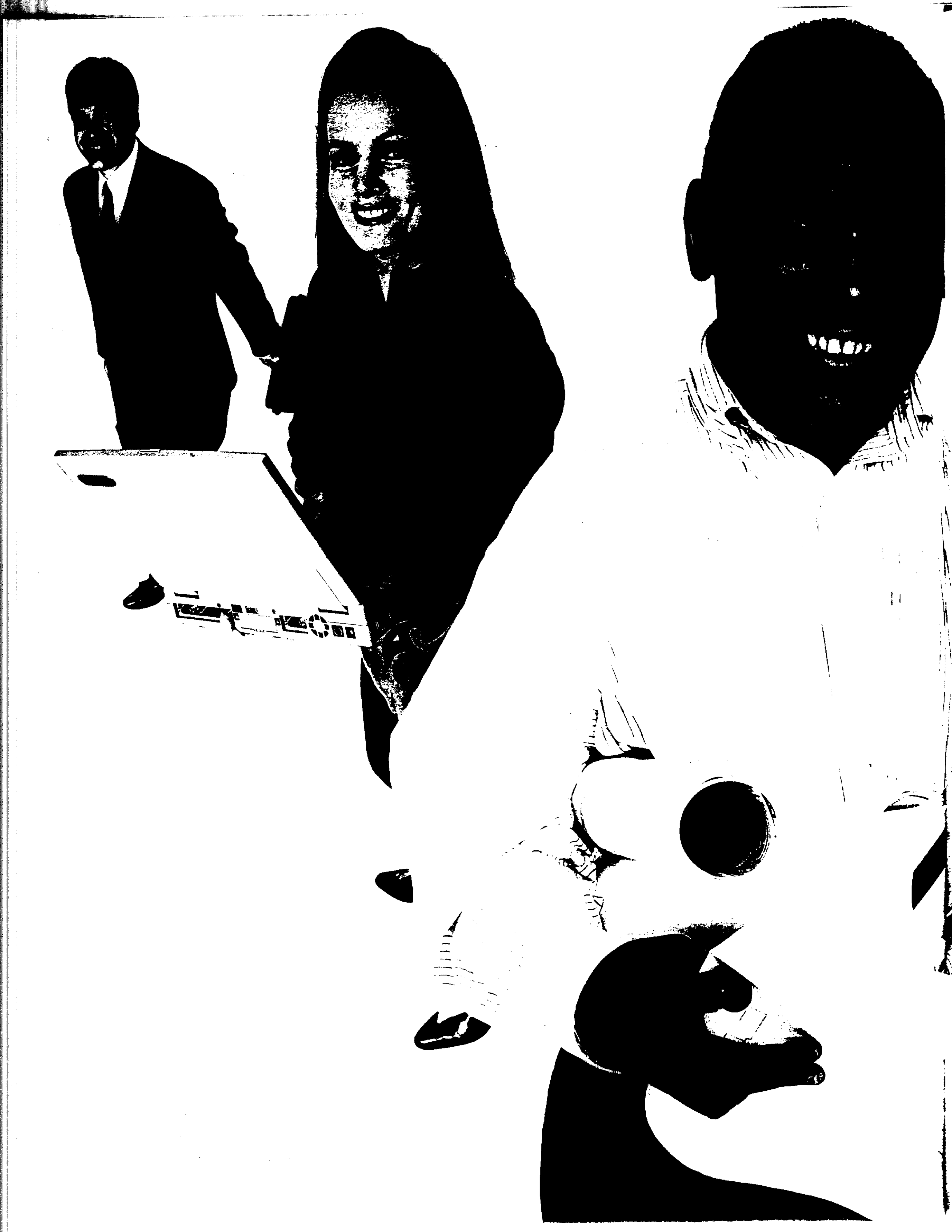
Resources

TCG has always relied upon two basic principles: Own and control your own network and empower employees by giving them the right tools to deliver the best service. By choosing the right people, providing them with the right training, and installing the right systems and processes, TCG's managers and associates ensure the reliability of our network, the quality of our services and the satisfaction of our customers.



"THE PEOPLE AT TCG DO MORE THAN ENSURE THE RELIABILITY OF OUR FLOOR OPERATIONS AND TRADING ROOMS. THEY GIVE ME CONFIDENCE THAT WHATEVER MY SITUATION REQUIRES, I CAN COUNT ON THEM FOR WHATEVER IT TAKES."

Victor Hargrove,
Communications Manager,
Gruntal & Co.



Focus

Every business customer of TCG can choose another local telecommunications carrier. We are keenly aware of the competition. And we welcome the challenge. What makes us confident? More than a decade spent in satisfying the most demanding customers in the world. They value our superior customer service. They prize our innovative and tailor-made solutions.

"WORLD-CLASS PATIENT CARE CREATES A DYNAMIC, DEMANDING ENVIRONMENT WHERE THERE'S NO ROOM FOR OUTDATED TELECOMMUNICATIONS TECHNOLOGY AND NO PATIENCE FOR OUTDATED SERVICE. TCG'S DEDICATED TEAMS LISTENED, HEEDED WHAT WE SAID, DELIVERED ON WHAT WE NEEDED AND NEVER RELAXED THEIR COMMITMENT OR THEIR SUPPORT."

Patrick Carney,
Vice President
and Chief
Information Officer,
Staten Island
University Hospital


TCC

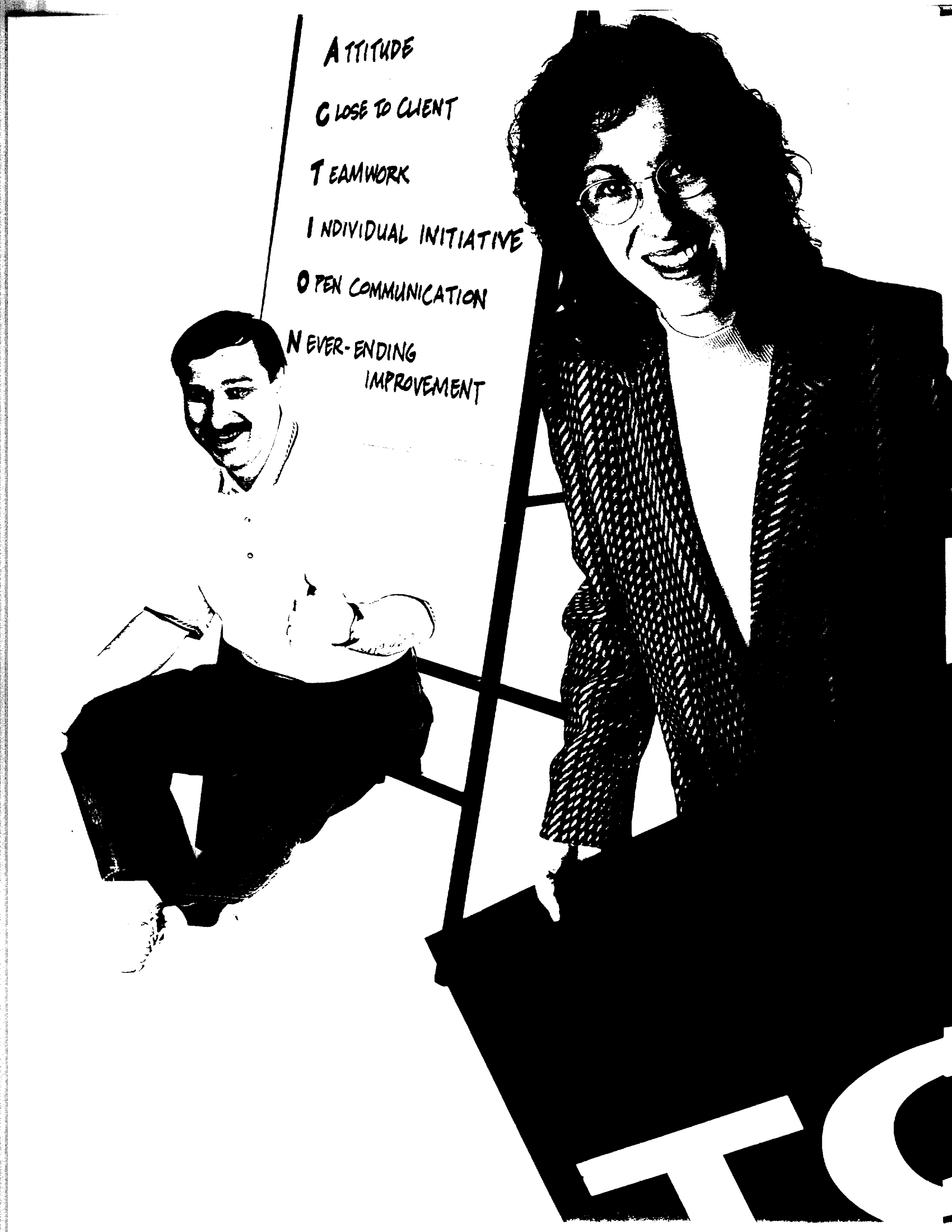
Vision

Before competition in long distance phone service, and long before the 1996 Telecom Act, TCG believed that local telephone service competition was possible. Unconventional thinking in 1983.

The vision was father to the company, mother to an industry and salvation to businesses nationwide. For the few who believed in us then, for the thousands who call us their phone company today, we say "thank you." And please call again.

"WELL BEFORE POLICYMAKERS FOCUSED ON COMPETITIVE LOCAL TELECOMMUNICATIONS, TELEPORT WAS MAKING IT HAPPEN. ITS VISION HAS EXPANDED TELEPHONE SERVICE CHOICES AVAILABLE IN COMMUNITIES AROUND THE NATION, AND EXPANDED HOW WE THINK ABOUT TELECOMMUNICATIONS."

Reed Hundt,
Chairman,
Federal Communications Commission, 1993-1997


ATTITUDE
CLOSE TO CLIENT
TEAMWORK
INDIVIDUAL INITIATIVE
OPEN COMMUNICATION
NEVER-ENDING IMPROVEMENT

1991

- Cox Enterprises Inc. buys a 12.5 percent stake in TCG.
- *TCG releases its first* "Nine Points" plan covering the critical administrative, *financial and* operational conditions needed before effective local exchange services competition can develop
- TCG begins public payphone trials in New York
- TCG becomes the [illegible] local carrier in New York to offer connectivity for [illegible] ISDN [illegible]
- [illegible] California [illegible] and [illegible]
- [illegible] route miles [illegible]

1992

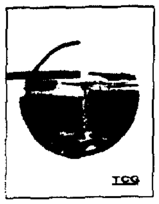
- Tele-Communications, Inc. buys a 49.9 percent stake in TCG; Cox Enterprises *increases its stake to* 50.1 percent.
- TCG opens in Seattle and San Diego.
- Illinois Commerce *Commission* authorizes TCG to provide enhanced local switched service in Chicago.
- *FCC responds to* TCG's 1987 petition for colocation by ordering telephone companies to *provide expanded* interconnection for interstate special access.
- TCG rolls out *LANLINK*, a data service for high efficiency token ring or Ethernet local area network *interconnection*.
- MSAs: 10; route miles of fiber: 891

1993

- *TCG establishes* Affiliate Services division to create local telecommunications joint ventures *with cable television* systems and other *fiber* optic-based service providers.
- Comcast Corp. and Continental Cablevision each purchase 20 percent stakes in TCG *from* TCI and Cox.
- TCG announces joint ventures with 11 cable television operators *for* networks in Detroit, Phoenix, South Florida (*Miami*, Ft. Lauderdale and West Palm Beach), Hartford and St. Louis.
- *MSAs: 18; route miles of fiber:* 1,953

1994

- TCG in New York becomes the nation's *first Competitive* Local Exchange Carrier (CLEC).
- Washington, Maryland, Michigan, *Massachusetts and* Illinois also permit local telephone service competition.
- Over 1,000 managers and associates nationwide.
- MSAs: 33; route miles *of fiber:* 3,092



1995

- TCG introduces Advanced Intelligent Network (AIN) *platform for a new* generation of customized services and applications, including number *portability*.
- TCG rolls out new ATM-based switched data services in all of its operating networks.
- TCG pioneers technical trial in Arlington Heights, Ill. for delivery of residential phone service over cable television lines.
- MSAs: 48; route miles of fiber: 5,428

1996

- June 27 Initial Public Offering raises $1.3 billion in equity and debt.
- TCG introduces 155 mbps OmniRing℠ OC3c service for broadband private line services to government *agencies and large* interexchange carriers (IXCs).
- TCG introduces TCG USA (United Savings *Advantage) plan for* switched services allowing customers to reduce costs by consolidating local *office usage*.
- TCG introduces Omnistream℠, native ATM service, and Fast Ethernet service.
- TCG wins contract to provide payphone services to Phoenix's Sky Harbor International Airport.
- TCG introduces residential local telephone service to large apartment complexes in New York City.
- TCG opens new, state-of-the-art National Customer Service Center near Denver.
- TCG inaugurates Howard W. Bruhnke Advanced Technology Center, a complete *telecommunications* technology laboratory, at Staten Island headquarters.
- MSAs: 57; route miles *of fiber:* 6,744

1997

- TCG completes *its acquisition of* CERFnet Services, Inc. CERFnet becomes TCG's Internet business unit.
- *TCG completes* its acquisition of Eastern TeleLogic Corp., Philadelphia's largest CLEC, to com- *plete its Northeast* corridor from New Hampshire to northern Virginia.
- TCG acquires remaining interest in BizTel Communications, Inc., a holder of 38 GigaHertz (GHz) licenses in 213 geographic areas.
- *City of* San Diego selects TCG as its local phone company, displacing *the ILEC*.
- TCG announces PrimeDistance℠ bundled long distance service.
- *TCG agrees to acquire* ACC Corp., a provider of competitive telecommunication services in the U.S., Canada and Western Europe, in a stock-*for*-stock merger
- TCG agrees to acquire Kansas City Fiber Network
- MSAs: 65; route miles of fiber: 9,474

1998

- January 8, TCG and AT&T agree to merge *in a stock-for-stock* transaction that values TCG at more than $12 billion at the close of trading that day. *TCG to lead* AT&T's local services unit after state and *federal regulatory* approvals received.
- NYPSC commends *TCG for its "high* quality of telephone service" provided in 1997.

IN MEMORIAM:

Edward Varone

Louis Hartmann

Howard Bruhnke

Vincent D'Esposito
Gaetano Liguori
John Pope

Robert Bulman
Anthony Catalanotto
James Doring
Ronald Ferrazzi
Katherine Zimoski

The History of TCG

1983

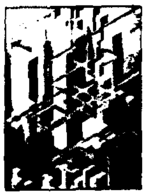
- Merrill Lynch Telecommunications [illegible] and Western Union Communications [illegible] form [illegible]
- New York [illegible] [illegible] develop [illegible] project
- [illegible] breaks ground for The Teleport satellite communication center in Staten Island, New York

1984

- Divestiture of the Bell System is completed
- TC begins construction of a New York metropolitan area fiber optic network and transmission facilities

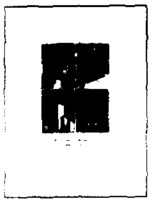
1985

- TC's around-the-clock Network Management Center begins monitoring its fiber optic metropolitan area network
- TC becomes the first local carrier to provide DS3 (45 mbps) service in New York
- TC debuts satellite service from The Teleport
- New York Public Service Commission (NYPSC) authorizes TC to become the first competitive local carrier offering intrastate, intracity private line services
- MSAs: [illegible] route miles of fiber: [illegible]



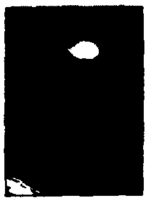
1986

- TC and New Jersey Bell complete the nation's first central office interconnection ("colocation") between a competitive local carrier and Incumbent Local Exchange Carrier (ILEC)
- TC asks NYPSC to require New York Telephone to provide colocation
- NYPSC authorizes [illegible] to provide shared-tenant service at The Teleport
- Over 40 companies and 55 buildings connected to fiber network; 25 satellite customers served
- MSAs: [illegible] route miles of fiber: [illegible]



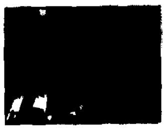
1987

- Teleport Communications Group (TCG) formed.
- TCG plans Boston network and continues to expand New York operation
- TCG asks FCC to order New York Telephone to provide colocation
- MSAs: [illegible] route miles of fiber: [illegible]



1988

- TCG sells its satellite earth stations to focus on core local telecommunications services.
- TCG cofounds the Associations for Local Telecommunications Services (ALTS), the competitive local carriers' industry trade organization
- Fidelity Communications Inc becomes a partner in TC-Boston
- TCG becomes the first U.S. local carrier to offer European-standard DS1 (2.048 mbps) service
- TCG begins Holiday Calls tradition of giving senior citizens free worldwide calling during the year-end holiday season
- MSAs: 2; route miles of fiber: 207



1989

- TCG expands to Houston, Los Angeles and San Francisco
- TCG establishes TC Systems Inc. to develop and manage complex networks for major business and government entities
- NYPSC invites TCG to participate in statewide Integrated Services Digital Network (ISDN) trial
- NYPSC issues landmark decision ordering New York Telephone to provide TCG with colocation
- MSAs: [illegible] route miles of fiber: 23[illegible]

1990

- TCG expands to Dallas and Chicago.
- TCG in New York begins operating nation's first colocation
- TCG introduces enhanced local switched service in New York with its purchase of two Class 5 ISDN-capable digital switches
- MSAs: 7; route miles of fiber: 274

For more than a decade, TCG has unambiguously demonstrated its ability to adapt, to compete, to lead and to succeed. We now have an unparalleled opportunity to combine this entrepreneurial experience and adaptive organization with AT&T's world-class capabilities and premier global brand name.

As noted in the January announcement, once the merger is completed, TCG will be at the core of AT&T's local services initiatives to give businesses nationwide a real choice of local telephone service providers. The larger vision, however, is to develop direct access to *every* customer in this country with only minimal reliance upon our competitors, the Incumbent Local Exchange Carriers (ILECs).

But achieving that goal is years away.

In the meantime, however, we will do as we have always done: "Trust in Us." TCG has invested nearly two billion dollars in its own facilities-based "wired" local fiber optic networks and is aggressively deploying its 38 GHz broadband "wireless" capacity.

In 1997, we announced plans to acquire key companies like Rochester, New York-based ACC Corp., a provider of competitive local and long distance telephone services in the United States, Canada, the United Kingdom and Germany, as well as Kansas City Fiber Network, a competitive local company serving the Kansas City metro area. Once these acquisitions are concluded, TCG will operate in 83 major U.S. markets, including 29 of the nation's top 30 markets, and in major markets in three foreign countries.

The enormous goal that we have set for ourselves in expanding local telephone service competition will require a vigorous and sustained commitment to growth: expand existing networks and build new ones, enlarge our base of strategic allies, and adapt new and existing technologies to reach more consumers. This goal will not be achieved soon, nor inexpensively. But at stake is the future of local telephone service choice in this nation.

Together, TCG and AT&T have embarked upon a telecommunications undertaking without equal in modern times.

Nor could AT&T have chosen a better partner. No other company in the nation's telecommunications industry is better prepared or more capable than TCG to compete and lead such an undertaking. From my discussions with the leaders of AT&T, I know that our ability to adapt and succeed against powerful competitors was among the most valuable assets they prized.

If greatness is measured by the magnitude of the challenge we face, then TCG is indeed fortunate. But what sustained us in 1983 and what continues to inspire our confidence about the great task that lies ahead is the spirit and character of TCG's managers and associates. From the beginning they set us apart. Today, they are unmatched.

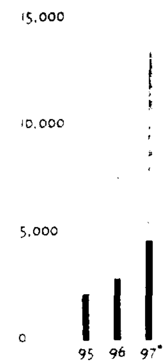
Now, together with AT&T, we are forging an unbeatable combination. Together, as AT&T saw, and as our competitors realize, the opportunity is ours and the truth is in the song lyric: "Ain't no stoppin' us now."

Thank you.

Robert Annunziata

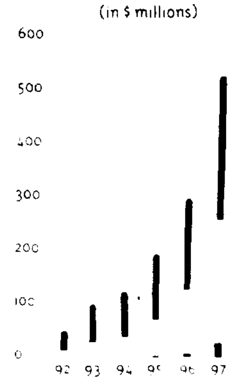
Chairman, President and CEO

NUMBER OF BUILDINGS

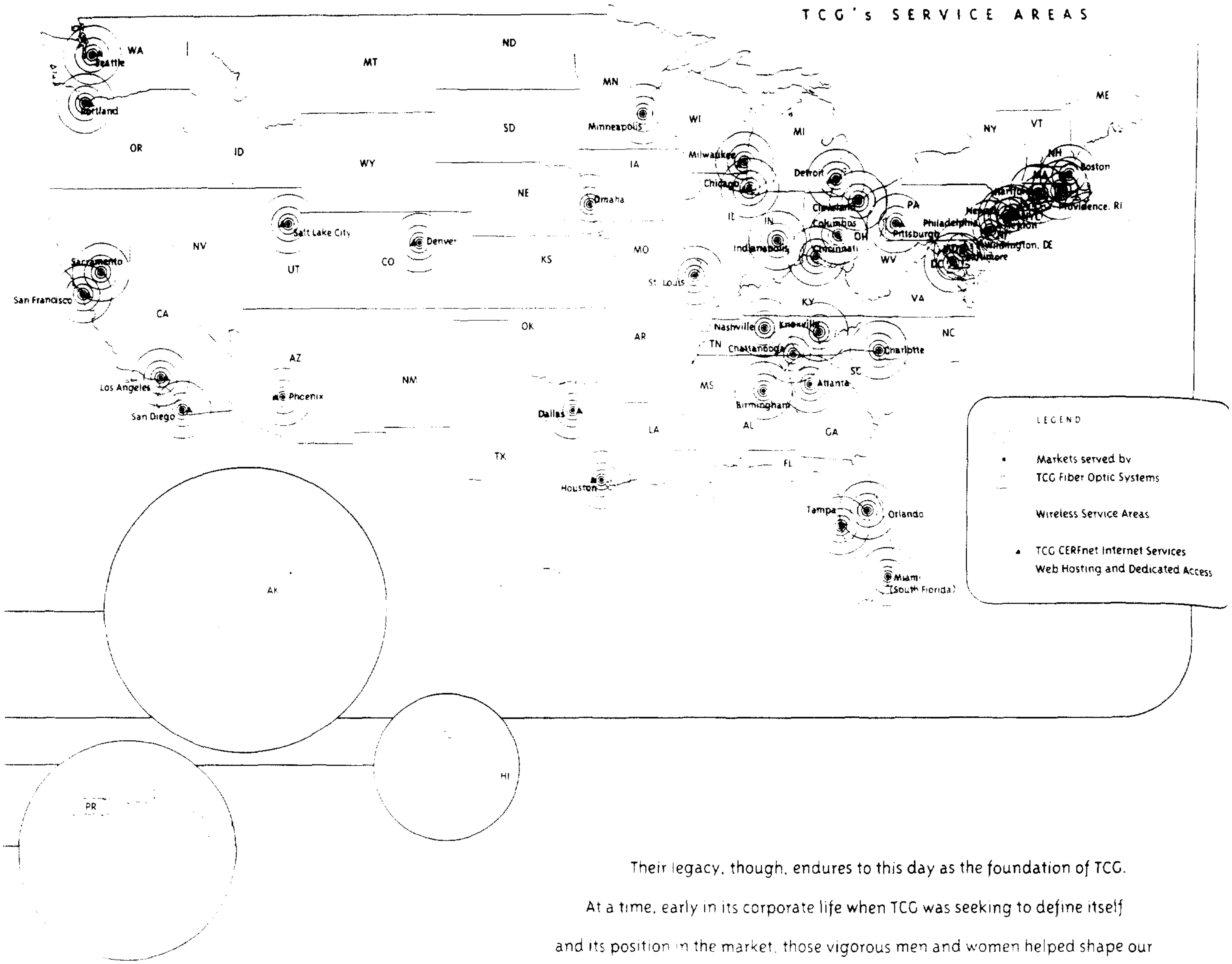


Off-net
• On-net
*Includes BizTel

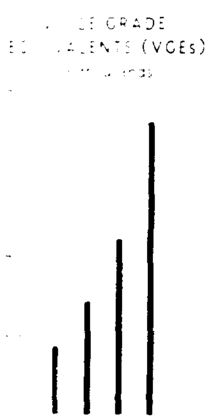
REVENUE MIX
(in $ millions)



Switched
• Dedicated (Revenues for the years prior to 1997 are presented on a pro forma basis.)
• Enhanced Data/Internet



Their legacy, though, endures to this day as the foundation of TCG. At a time, early in its corporate life when TCG was seeking to define itself and its position in the market, those vigorous men and women helped shape our corporate character by adhering to the basic principles that we still uphold today: Respect for the individual, teamwork, excellence in service, commitment and integrity.



Those fundamental principles are the "headware" for TCG and the complement to the more tangible hardware and software that is today's TCG. We call them our ACTION Principles, and they embody the spirit behind TCG's dedication to never-ending improvement and superior customer service.

ACTION is no hollow or empty slogan. Our commitment to our customers is real and distinguishes TCG in the marketplace. And we support that commitment through TCG's advanced local telecommunications infrastructure. Wherever they are, TCG's managers and associates can rely upon an unequaled "hardware" infrastructure of fiber optics, advanced digital switches, multiplexers and broadband wireless systems for TCG's network operations, while sophisticated "software" drives TCG's innovative and advanced Operations Support Systems (OSS) that provide our unsurpassed customer care and control our networks.

Collectively, TCG's "headware, hardware and software" underpin TCG's ability to be "Adept at Adapting" — to adjust, change and react swiftly to developments in the marketplace, and changes in the regulatory, technology and business environments.

What has inspired the cont[illegible] these investors [illegible] I believe that right from the very beginning, they grasped the obvious and [illegible] of TCG: the strength of [illegible] management and the spirit of the people who started the company with me. [illegible] eers accepted the risk [illegible] challenges, as have all those TCG managers and associates who followed them [illegible] ntribution to TCG [illegible] telephone service competition.

Many of those early colleag[illegible] — like Walt Schaefer, Archie Nelson, John Thomson, Maria Terranova-Evans, Dewey Coscia, Kathy Galvin Sv[illegible], Mike Aldridge, Maria Dei[illegible] and John Reiser and Don Helms, among others — are still here at TCG. Some others, [illegible] are not. As we have grown to more than 3,000 employees, we have experienced the untimely loss of some of these [illegible] including Howard Brunner, who was co-founder with me of TCG.

Chairman's Letter

To Our Shareholders, Friends, Managers and Associates:

SEQUENTIAL
QUARTERLY EBITDA
(in $ millions)

Fifteen years ago, Teleport Communications Group introduced an unprecedented vision of local telephone service. It was called competition.

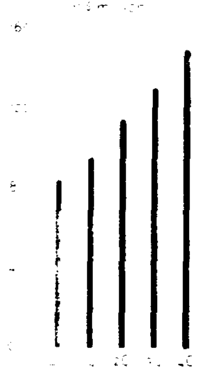
Our premise was simple: Give customers what they need, when they need it. If we offered more responsive, customer-focused service, state-of-the-art technology and more cost-effective pricing, we were convinced that we could successfully challenge the entrenched local telephone monopolies.

I guess we were right. TCG today serves 65 major markets nationwide and we've announced plans to acquire two additional companies that, when completed, will give us operations in 83 markets plus Canada, the United Kingdom and Germany. As we expand, we bring to more consumers an array of high quality voice, enhanced data, Internet and long distance services unmatched by any other competitive local telecommunications company.

Our financial results parallel our growth in services and new markets. Revenues and EBITDA (earnings before interest, taxes, depreciation and amortization) have grown consistently. For 1997, TCG revenues were $494.3 million, an increase of $210.9 million — 74 percent above 1996 pro forma results, while Recurring EBITDA* rose to 9.1 percent of revenues — more than double 1996 pro forma results.

These numbers validate our success. More than that, the achievements they stand for say a great deal about our corporate character. In 1983, TCG was a new and fragile enterprise with an uncertain future. We faced many obstacles as we strove to provide superior customer service, introduce new products and services, push critical regulatory initiatives, make the right acquisitions and deploy advanced technology. Through its vision, focus, resources and speed, however, TCG hurdled the barriers and in the process transformed the telecommunications industry.

SEQUENTIAL
QUARTERLY REVENUE
(in $ millions)



Now, the momentum of that transformation is accelerating.

On January 8, 1998, TCG and AT&T agreed to merge in a stock-for-stock transaction that, at the close of business that day, valued TCG at more than $12 billion. We expect to receive the necessary governmental approvals and conclude the merger later this year. Therefore, this is my *last* Chairman's Letter as the head of TCG.

So, it is only fitting that I now take this opportunity to acknowledge the contributions of so many who were instrumental in achieving the success that TCG enjoys today, including our people, our principal investors (Tele-Communications, Inc., Cox Communications and Comcast Corporation), our public shareholders and lenders, and the vendors who created the electronics and equipped our network to serve our customers.

It all began in 1983 when Merrill Lynch and Western Union invested $18 million in a startup venture called Teleport Communications to improve New York City's telecommunications infrastructure. No one at that time could have guaranteed the success of that investment. Nor could anyone have predicted with much more certainty the outcome in 1992 when our cable television company investors took over from Merrill Lynch (which had acquired Western Union's stake), and began to fund our ambitious growth and expansion plans with an investment that would amount to more than $750 million.

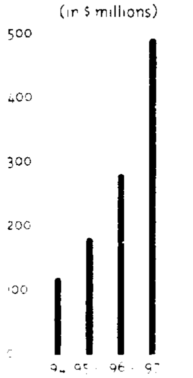
Finally, the public, like our private investors, was given an opportunity to express its confidence in our vision when we launched our Initial Public Offering on June 27, 1996. On that day, TCG successfully raised more than $1.3 billion in debt and equity.

* Recurring EBITDA (EBITDA prior to a one-time charge for in-process research and development of $22 million).

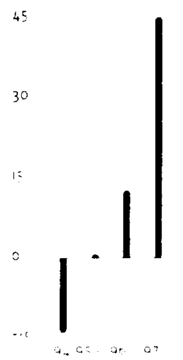
SUPPLEMENTAL DATA

(In Thousands)	Years Ended December 31, Consolidated 1997	Consolidated 1996	Combined 1995	Pro Forma for the TCG Reorganization Years Ended December 31, 1996	1995
Results of Operations and Other Data:					
Revenues	**$ 494,304**	$ 267,669	$166,169	$ 283,383	$184,852
EBITDA(1)	**44,887**	25,053	22,576	12,573	589
Fixed assets — at cost	**1,873,083**	1,304,229	545,653	1,304,229	946,026
Total assets	**2,456,301**	2,050,097	614,793	2,050,097	960,137
Employees	**3,059**	2,050	1,499	2,050	1,499

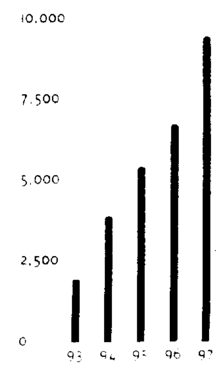
ANNUAL REVENUE
(in $ millions)



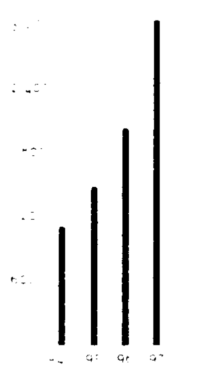
ANNUAL EBITDA
(in $ millions)



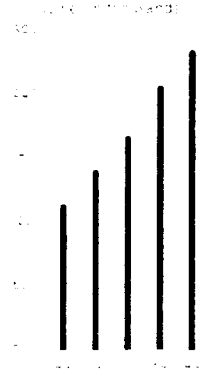
ROUTE MILES



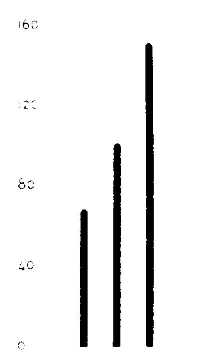
EMPLOYEES



LOCAL ACCESS LINES



LOCAL SERVING OFFICES (LSOs)



(1) EBITDA consists of earnings (loss) before interest, income taxes, depreciation, amortization, minority interest and equity in losses of unconsolidated affiliates. It is a measure commonly used in the telecommunications industry and is presented to assist in understanding TCG's operating results. EBITDA is not intended to represent cash flows or results of operations in accordance with U.S. GAAP for the periods indicated. In 1997, this amount represents Recurring EBITDA which is defined as EBITDA excluding a one-time in-process research and development cost.

(2) Unaudited pro forma financial information is prepared as if the TCG reorganization had occurred at the beginning of each of the respective years.

Teleport Communications Group Inc. (TCG) provides high quality local and long distance telecommunications services including voice, data, video, and Internet services throughout the United States. TCG is the first and largest carrier in the emerging competitive local telecommunications industry. Critical to TCG's success is its ability to build and manage its own network infrastructure utilizing sophisticated fiber optic and wireless technologies. Customers include information-dependent financial institutions, banks, brokerage firms, media companies, government, hospitals, educational institutions, and a wide range of other industries and businesses that depend on accurate and reliable communications. They value TCG's excellent customer service, superior operating standards and innovative spirit.

Attitude

Close to Client

Teamwork

Individual Initiative

TCG

TELEPORT COMMUNICATIONS GROUP

1997 Annual Report